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No. 06-937

In the Supreme Court of the United States

QUANTA COMPUTER, INC., QUANTA COMPUTER USA, INC., Q-LITY COMPUTER, INC., COMPAL ELECTRONICS, INC., BIZCOM ELECTRONICS, INC., SCEPTRE TECHNOLOGIES, INC., FIRST INTERNATIONAL COMPUTER, INC. AND FIRST INTERNATIONAL COMPUTER OF AMERICA, INC.,

Petitioners.

v.

LG ELECTRONICS, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF OF DELL INC., HEWLETT-PACKARD, CO., AND GATEWAY, INC. AS AMICI CURIAE IN SUPPORT OF PETITIONERS

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BRIEF OF DELL INC., HEWLETT-PACKARD, CO., AND GATEWAY, INC. AS AMICI CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF THE AMICI CURIAE

Amici Dell Inc., Hewlett-Packard Company, and Gateway, Inc. are leading manufacturers of personal computers.[1] Many of the computers manufactured by amici incorporate microprocessor chips manufactured by Intel Corporation and memory components manufactured by other companies. In some cases, amici purchase the chips and memory as a single assembled component from an outside firm. In others, amici purchase the chips and memory separately and assemble the sub-components themselves. Petitioners are among the firms from which amici purchase the assembled component.

Respondent LG Electronics, Inc. takes the position — endorsed by the Federal Circuit in this case — that even though it has received a royalty from Intel for patents allegedly infringed by Intel's microprocessor chips, it can extract another royalty payment from petitioners because it required Intel to send petitioners a notice stating that they did not receive a "license" from respondent to use Intel products "by combining [them] with any non-Intel product." Pet. 3. If the Federal Circuit's decision is permitted to stand, and petitioners are required to enter into similar license arrangements with respondent, respondent then could claim that it can impose a similar condition on any licenses it issues to petitioners, seeking to require amici to pay yet a third royalty for use of the same articles.

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[1] Pursuant to Rule 37.6, amici affirm that no counsel for a party authored this brief in whole or in part and that no person other than amici and its counsel made a monetary contribution to its preparation or submission. The parties' letters consenting to the filing of this brief have been filed with the Clerk's office.

Of course, the Federal Circuit's legal standard is not limited to respondent. The computers manufactured by amici, and many other technology products as well, consist of hundreds or even thousands of components, each of which can implicate a number of patents. Many of those components, like the component here, are manufactured and assembled in multiple steps by multiple entities before reaching amici. The regime created by the Federal Circuit's interpretation of the patent exhaustion doctrine allows each patent owner to work its way through the manufacturing chain, extracting a separate royalty for the same invention at each stage of the process. That gives the patent owner much more than the reward it is due for its invention, thus adding unjustified costs to the manufacturing process without serving the purposes of the patent system.

Amici therefore have a strong interest in urging the Court to grant review and overturn the Federal Circuit's patent exhaustion jurisprudence, which is directly contrary to the patent exhaustion principles previously articulated by this Court.

INTRODUCTION AND SUMMARY OF ARGUMENT

The doctrine of patent exhaustion historically has appropriately circumscribed the bundle of rights granted to patentees. It ensures that the patentee receives fair compensation for its invention, provides simplicity to the patent system, and guarantees peace for owners of patented articles.

The Federal Circuit has abandoned the doctrine of patent exhaustion, as it has been defined by this Court for over a century, and replaced it with a regime that serves no useful purpose but to multiply the recovery for clever patent-owners. The doctrine of patent exhaustion, once a definitional constraint on patent rights, has been reduced to a mere default rule of contract interpretation that easily is avoided, extending the rights of the patent-owner throughout the life of a patented article.

That transformation was accomplished by misinterpretation of this Court's prior decisions. Contrary to the Federal Circuit's interpretation, this Court's most recent and comprehensive discussion of patent exhaustion reiterates the traditional rule that all patent rights in an article are exhausted upon its first sale. The Federal Circuit dismissed this Court's holding by completely inverting the Court's reasoning and instead cited another, prior case as binding authority even though that prior case expressly declined to decide the relevant question.

Not only has the Federal Circuit departed from this Court's prior decisions, it also has created a regime that is contrary to the purposes of the patent system. The patent regime contemplated by the Federal Circuit's ruling is impractical, unfair, and inefficient. It does not best serve the purpose of the patent system — promoting the progress of science and the useful arts — but only furthers the goals of those seeking to extract multiple royalties on the same patented article. This Court should intervene and reassert the traditional, and well-conceived, doctrine of patent exhaustion.

ARGUMENT

Several times in recent years this Court has granted review in cases presenting important questions of patent law in order address claims that the Federal Circuit had adopted legal principles that are inconsistent with the relevant decisions of this Court. *E.g.*, *KSR Int'l Co.* v. *Teleflex, Inc.*, No. 04-1350 (argued Nov. 28, 2006); *MedImmune, Inc.* v. *Genentech, Inc.*, 127 S. Ct. 764 (2007); *eBay Inc.* v. *MercExchange, L.L.C.*, 126 S. Ct. 1837 (2006).

This case presents another example calling out for review. Misconstruing this Court's decision in *United States* v. *Univis Lens Co.*, 316 U.S. 241, 250 (1942), and undermining reasoned, well-settled patent policy, the Federal Circuit's ruling here — the culmination of a series of decisions beginning

with *Mallinckrodt, Inc.* v. *Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992) — permits patentees to invoke the patent infringement remedy to collect separate royalty payments at each stage of the manufacturing process and supply chain, the precise result ***rejected*** by this Court in *Univis Lens*. Review by this Court is plainly and urgently warranted.

A. The Legal Rule Applied By The Federal Circuit In This Case Is Inconsistent With This Court's Patent Exhaustion Jurisprudence.

"The declared purpose of the patent law is to promote the progress of science and the useful arts by granting to the inventor a limited monopoly, the exercise of which will enable him to secure the financial rewards for his invention." *Univis Lens*, 316 U.S. at 250 (citing U.S. Const., Art. I, § 8, cl. 8; 35 U.S.C. §§ 31, 40). That purpose "is fulfilled with respect to any particular article when the patentee has received his reward for the use of his invention by the sale of the article[;] * * * once that purpose is realized the patent law affords no basis for restraining the use and enjoyment of the thing sold." *Id.* at 251.

Accordingly, "[t]he first vending of any article manufactured under a patent puts the article beyond the reach of the monopoly which that patent confers." *Id.* at 252. And any condition on the use and enjoyment of a patented article after an authorized sale "derives ***no support from the patent***," but instead, "must stand on the same footing * * * as like stipulations with respect to unpatented commodities." *Id.* at 251 (emphasis added); see also *Keeler* v. *Standard Folding Bed Co.*, 157 U.S. 659, 666 (1895) (whether a patent-owner can impose conditions on the post-sale use and enjoyment of a patented article is "a question of contract, and not [a question] under the inherent meaning and effect of the patent laws").[2]

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[2]. *Accord United States* v. *Masonite Corp.*, 316 U.S. 265, 277-78 (1942) ("There are strict limitations on the power of the patentee to

This Court, in *Univis Lens*, also made clear that all patent rights are exhausted upon the first sale, "[w]hether the licensee sells the patented article in its completed form or sells it before completion for the purposes of enabling the buyer to finish and sell it." 316 U.S. at 252.

The Federal Circuit in this case nonetheless adopted a principle that allows a patent owner to avoid this Court's *Univis Lens* holding. According to the decision below, "[i]t is axiomatic that the patent exhaustion doctrine commonly referred to as the first sale doctrine, is triggered by an unconditional sale * * * [but] does not apply to an expressly conditional sale or license." *LG Elecs., Inc.* v. *Bizcom Elecs., Inc.*, 453 F.3d 1364, 1369 (Fed. Cir. 2006). In other words, the Federal Circuit has turned an essential constraint on the limited rights granted to a patentee — that it extends to the first authorized sale of an article manufactured under the patent but no further — into an optional limitation, easily avoided by altering the terms of sale.[3]

Although this is the first case in which the Federal Circuit has declared its voluntary version of the patent exhaustion doctrine to be "axiomatic," the Federal Circuit first parted ways with this Court's jurisprudence 15 years ago in *Mallinckrodt*. That opinion is the foundation of the Federal

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attach conditions to the use of the patented article. As Chief Justice Taney said in *Bloomer* v. *McQuewan*, 14 How. 539, 549, when the patented product 'passes to the hand of the purchaser, it is no longer within the limits of the monopoly. It passes outside of it, and is no longer under the protection of the act of Congress.'").

[3] The district court found that the factual predicate relied upon by the Court in *Univis Lens* is present here: the microprocessors sold to the defendants by Intel were "destined * * * to be finished by the purchaser in conformity with the patent because they have no reasonable non-infringing use." *LG Elecs., Inc.* v. *Asustek Computers, Inc.*, 248 F. Supp. 2d 912, 915 (N.D. Cal. 2003) (internal quotation marks omitted). That factual finding was not disturbed on appeal.

Circuit's erroneous version of the patent exhaustion doctrine and demonstrates that the Federal Circuit has misunderstood — if not outright rejected — this Court's decision in *Univis Lens*.

Mallinckrodt held that a restriction on the post-sale use and enjoyment of a patented article is enforceable under the patent laws as long as it does not "venture[] beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason." 976 F.2d at 708. That ruling arose primarily from the Federal Circuit's misinterpretation of two cases: *General Talking Pictures Corp.* v. *Western Electric Co.*, 305 U.S. 124 (1938), and *Univis Lens*.

Mallinckrodt cited *General Talking Pictures* — rather than *Univis Lens* — as if it were the governing precedent from this Court (see 976 F.2d at 701) and interpreted that decision to authorize a patent owner to impose conditions on the use and enjoyment of articles manufactured and sold under a patent (*id.* at 704-06). The Federal Circuit's error rests on its confusion of two lines of decisions — those dealing with limitations on a license to ***manufacture*** a patented device and those dealing with limitations on the ***downstream use*** of a patented device.

General Talking Pictures involved a license to manufacture a patented device only for certain fields of use. Limitations on a license to manufacture a patented device — as opposed to limitations on the use and enjoyment of a device after it has been sold — generally are enforceable under the patent laws. *E.g.*, *Gen. Talking Pictures*, 305 U.S. at 127; *United States* v. *Gen. Elec. Co.*, 272 U.S. 476, 489-90 (1926). In *General Talking Pictures*, the manufacturing licensee and a purchaser agreed that the licensee would make, and the purchaser use, certain of the patented devices for a use that was excluded under the license to manufacture. In other words, they conspired to violate the license to manufacture. The patentee sued for infringement.

This Court held that the devices in question "were made and sold outside the scope of the license" which is "precisely the same as if no license whatsoever had been granted." *Id.* at 127. Therefore, the manufacturer "was guilty of an infringement when it made the [devices]"(*id.* at 126) and the devices that it made "were not manufactured or sold 'under the patent(s)'" (*id.* at 125). With respect to the purchaser, the Court held that it too was guilty of infringement because it "ordered, purchased and leased [the unlicensed devices] knowing the facts" (*id.* at 126), placing it "in no better position than if it had manufactured the [devices] itself without a license" (*id.* at 127).

The Court did ***not*** hold that the limitations in the license to manufacture would have constrained the downstream use and enjoyment of the articles by the purchaser if the articles had been manufactured under the patent license. In fact, the Court explicitly said that it had "no occasion to consider what the rights of the parties would have been if the [device] had been manufactured 'under the patent' and 'had passed into the hands of a purchaser in the ordinary channels of trade.' Nor [did it have] occasion to consider the effect of a 'licensee's notice' which purports to restrict the use of articles lawfully sold." *Id.* at 127.

Four years later, in *Univis Lens*, the Court considered those precise issues. It held that the authorized sale of an article manufactured "under the patent" exhausts all patent claims in the article regardless of any purported limitation on the subsequent use and enjoyment of the article.[4] Indeed, the Court characterized the patentee's attempt to enforce conditions on the use and enjoyment of the patented article after an authorized sale as an effort to "extend [the patent monopoly] beyond the fair meaning of the patent statutes and the con-

[4] That is the situation here: there is no dispute that Intel's microprocessor chips are manufactured under the license granted to Intel by LGE.

struction which has hitherto been given to them." 316 U.S. at 252.

Mallinckrodt did not acknowledge that *Univis Lens* is this Court's most recent and most relevant holding on the proper scope of the patent exhaustion doctrine; it seemed not to understand that *Univis Lens* answered the questions that were explicitly left unanswered in *General Talking Pictures*. Instead, *Mallinckrodt* relegated *Univis Lens* to a single parenthetical reference, interpreting it to bar the use of patent law to enforce a condition on the post-sale use and enjoyment of a patented article only if that condition violates the antitrust laws. See 976 F.2d at 708.

In fact, as we have discussed, *Univis Lens* held that a condition on the post-sale use and enjoyment of a patented device violated the antitrust laws ***because*** it was not enforceable under the patent laws, and thus was not protected against antitrust scrutiny. See 316 U.S. at 252 ("[t]he price fixing features of appellees' licensing system, which are not within the protection of the patent law, violate the Sherman Act").

The Federal Circuit compounded its error by stating that, unless limitations on the subsequent use and enjoyment of a patented article are unlawful, "private parties retain the freedom to contract concerning conditions of sale." *Mallinckrodt*, 976 F.2d at 708. But a patentee's "freedom to contract" is not at issue under the patent exhaustion doctrine. A patentee is free to impose downstream conditions on the sale of a patented article, enforcement of which will depend on the same principles of contract law that would govern similar conditions on the sale of a non-patented article. See *Univis Lens*, 316 U.S. at 251; *Keeler*, 157 U.S. at 666.

The relevant question under the patent exhaustion doctrine, however, is whether the patent owner can utilize the rights granted by the patent laws to collect multiple additional royalties from downstream users of the patented good.

This Court said "no" in *Univis Lens*. The Federal Circuit's opposite conclusion here warrants review by this Court.[5]

B. The Federal Circuit's Rejection Of Fundamental Patent Exhaustion Principles Is Inconsistent With The Purposes Of The Patent Law And Rests On An Inaccurate Conception Of Royalty Negotiations.

The Federal Circuit rationalized the result in this case as follows: "The theory behind" the patent exhaustion doctrine is that, in "[a]n unconditional sale of a patented device," "the patentee has bargained for, and received, an amount equal to the full value of the goods," but in "an expressly conditional sale or license * * * it is more reasonable to infer that the parties negotiated a price that reflects only the value of the 'use' rights conferred by the patentee." 453 F.3d at 1369-70.

As we have discussed, that analysis confuses the legal basis for the patent exhaustion doctrine: it does not rest on an assumption about the patent owner's intent in making the sale, but instead is a limitation on the bundle of rights granted to patent owners. Setting aside its legal pedigree, however, the Federal Circuit's "intent-based" patent exhaustion doctrine is bad policy founded on a false premise.

The regime envisaged by the Federal Circuit, where patent-owners can partition their patent rights in a patented article and sell them piecemeal, obtaining a portion of the total

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[5] As petitioners observe (Pet. 26-27), because software users typically create new copies of a software program whenever the program is used, a patent owner's ability to impose conditions on the use of software flows from the broader rights of a patent owner to control the manufacture of a patented good. For similar reasons, the distributor of copyrighted software can evade the first sale doctrine through licensing rather than sale of the software. There is of course no manufacturing of additional copies of the components at issue in this case — or with respect to the sale of patented articles consisting of physical components generally.

royalty from each entity that purchases or uses the article (presumably according to the proportional value derived from the invention by each entity), is economically and practically unrealistic.

Contrary to the assumption underlying the Federal Circuit's regime, the power of the patent with respect to a future purchaser is not diminished by a license limited to the initial manufacturer. If petitioners are required to pay another royalty for the use of respondent's patents, respondent will have the same bargaining power with respect to petitioners as if respondent had not licensed Intel at all — the prior license to Intel has no value for petitioners and Intel's prior use under its license did not diminish the value to petitioners of the right to use the invention.

Indeed, respondent's negotiating leverage likely would be enhanced with respect to users in succeeding levels of the manufacturing or supply chain. To the extent petitioners' principal supplier, Intel, had entered into a license agreement with respondent — rather than, for example, designing its product to avoid respondent's claims — petitioners would have little option but to accede to a license. The alternative would be to look for another component supplier, which could be difficult if, for example, patents held by Intel were essential to supply components that meet petitioners' needs.

Similarly, if respondent obtains another royalty from the petitioners and requires them to accept a license that does not extend to a subsequent purchaser, amici will find themselves bargaining with respondent on the same terms as if no prior royalties had been paid for the articles at issue. The reality is that amici will be asked to pay the third royalty on the same articles, not a fictional "fair proportional share" of the total royalty due to LGE.

Furthermore, there is no reason to think that this process will stop with amici. Under the Federal Circuit's opinion, respondent could seek to require amici to accept a limited li-

cense and then proceed to extract another layer of royalties from end-users who purchase amici's computers. This is a particularly troubling possibility given the Federal Circuit's holding that the sale of a patented article does not exhaust method claims at all — *i.e.*, that the patent exhaustion doctrine does not apply to method claims (453 F.3d at 1369-70) — even method claims that do not relate to the manufacture of further articles but are practiced only for their intrinsic value because they are necessary to the use and enjoyment of the invention itself. With appropriate contracting and notice to consumers, the opinion below would allow respondent to extract an annual licensing fee on every computer with Intel microprocessors inside.

The idea of a fair piecemeal partition of patent rights is particularly unrealistic in this context. The manufacture of amici's computers requires the fabrication or acquisition of hundreds, if not thousands, of separate components. Many of those components themselves are immensely complex amalgamations of various technologies. It is unrealistic to think that amici can accurately track, let alone negotiate the terms of, all potential patent license terms related to the components that make up their computers. But the regime created by the Federal Circuit ensures that every patentee with knowledgeable counsel eventually will come knocking on amici's doors after they have extracted royalties and limited licenses from upstream firms on the manufacturing chain.[6]

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[6] The facts underlying the patent claims in this case perfectly exemplify the point. The five patents cited by the Federal Circuit trace their parentage to applications filed from 1985 to 1988 and the patents themselves issued between 1990 and 1999. Respondent had no role in developing the inventions embodied in the patents, but simply acquired them from a third party. It is perfectly clear that this lawsuit is not about protecting respondent's inventive contributions to computer technology but about respondent reaping a windfall through aggressive licensing practices.

Moreover, as petitioners' redacted petition reveals, negotiations over patent rights and cross-licensing in the high technology field are very sensitive, confidential, and often quite literally opaque to other parties. The inability of downstream users to gain information about the outcome of prior negotiations is one more reason that the Federal Circuit's imagined regime of a fair piecemeal partition of the limited monopoly granted to a patentee is fantasy.

In short, the notion that underlies the Federal Circuit's doctrine of "intent based" patent exhaustion — that there will be a series of negotiations during which each entity that owns or uses the invention throughout the manufacturing process (and, thereafter, owns a "finished" product containing the invention) will pay its fair share of the royalty due to the patent owner — is simply false. Instead, the regime established by the Federal Circuit allows a clever patent owner to extract duplicative royalties each time that an article practicing its patent changes hands.

That regime may be good for patent owners, but it is not good patent policy. This Court always has been very clear that "the promotion of the progress of science and the useful arts is the 'main object' [of the patent system]; reward of inventors is secondary and merely a means to that end." *Masonite*, 316 U.S. at 278 (quoting *Pennock* v. *Dialogue*, 27 U.S. (2 Pet.) 1, 19 (1829) (citations omitted)). Allowing the patent owner to multiply its recovery by extracting a new, duplicative royalty at each stage of ownership does not promote the progress of science and the useful arts and thus does not serve the purposes of the patent system.

Indeed, even if the Federal Circuit's notion of a piecemeal partition of the monopoly were practically possible, it still would not make sense because of its inefficiency. This Court's traditional doctrine of patent exhaustion forces the patent owner to extract the entire royalty that it is due for its invention at a single point. The regime urged by respondent and endorsed by the Federal Circuit, on the other hand, re-

quires multiple points of negotiation between the patent owner and each entity that ever has owned or used the article embodying the invention. That obviously imposes unnecessary transactional costs on the manufacturing and supply-chain process and has no useful purpose but to magnify the recovery for the patent owner. Far from promoting, the Federal Circuit's regime affirmatively impedes the development of science and the useful arts.

By eviscerating the traditional doctrine of patent exhaustion, the Federal Circuit has realized the concern expressed by this Court over a century ago in *Keeler*. That opinion recounted the virtues of the traditional doctrine of patent exhaustion — a full reward for the inventor, simplicity for all parties, and peace for owners of the patented article — and opined that "[t]he inconvenience and annoyance to the public that an opposite conclusion would occasion are too obvious to require illustration." 157 U.S. at 666-67. Unfortunately, the predicted inconvenience and annoyance are now made real by the Federal Circuit's decision. This Court's intervention is required.

C. The Federal Circuit's Rule Threatens To Impose Duplicative — And Potentially Very Large — Royalty Costs On Technology Products And Other Products That Might Implicate Large Numbers Of Patents.

The practical implications of the Federal Circuit's ruling are enormous. We have discussed how it will permit respondent to seek to exact duplicative royalties at successive stages of the manufacturing process. But respondent's patents are only a few of the thousands of patents that may be implicated by the computers produced by amici.[7] Under the Federal Cir-

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[7] As several panelists explained to the FTC when it explored the issue, "the plethora of patents in the computer hardware industry makes it 'virtually impossible to search all potentially relevant pat-

cuit's rule, the owner of every single patent implicated by any component of a computer would be able to follow the same multiple-royalty-collection process as respondent.

And computers are not unique in this way. Technology products typically are made up of very large numbers of patented components. Thus, computers, cellular telephones, MP3 players, as well as airplanes, cars, and communications networks often contain thousands of different physical components, each of which may be the subject of many patents. See FTC, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY, Ch. 3, at 15-56 (Oct. 2003); Nat'l Research Council for the Nat'l Academies, A PATENT SYSTEM FOR THE 21ST CENTURY 37 (Stephen A. Merrill et al. eds., 2004); Carl Shapiro, *Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard Setting*, *in* 1 INNOVATION POLICY AND THE ECONOMY 119, 125-26 (Adam B. Jaffe et al. eds., 2000).

The Federal Circuit's ruling in this case will allow every owner of any patent that is infringed by such a product — and even an owner of a patent that simply might arguably be infringed — to engage in the same multi-level royalty-assessment strategy employed by respondent. It therefore threatens to impose a huge financial and practical burden on manufacturers of technology products.

It is no answer that a manufacturer can choose to contest the patent claim rather than pay the royalty. Patent infringement claims are easy to assert, but difficult to disprove. Especially in the technology context, the validity of a patent — as well as its legitimate boundaries — sometimes may be difficult to determine, which allows the assertion of extremely tenuous claims. See, *e.g.*, James Bessen & Michael J. Meurer, *Lessons for Patent Policy from Empirical Research*

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ents, review the claims,' and evaluate the infringement risk." FTC REPORT, *supra*, ch. 2 at 3.

on Patent Litigation, 9 LEWIS & CLARK L. REV. 1, 16 (2005) ("[C]ourt errors are difficult to avoid in patent litigation, because claim interpretation is complex and it is difficult for fact-finders to assess evidence of infringement. Thus, a deserving defendant may face a significant risk of liability.").

This Court should grant review to reestablish the well reasoned policy of patent exhaustion and thereby preclude the use of patent law principles to impose what amounts to the equivalent of a technology tax at every level of the manufacturing process.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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